Measuring New York City’s Budgetary Cushion: How Much is Needed to Weather the Next Fiscal Storm?

In determining the strength of New York City’s fiscal position, it is critical to assess the resiliency of its budget and fiscal outlook. In addition to how readily the budget can be adapted to raise revenues or cut expenditures when necessary, this resiliency is determined in part by the level of cushion available to cover unexpected revenue shortfalls or expenditure shocks without greatly disrupting City services. Forecasting revenues are the most volatile element of budgeting because revenues fluctuate with the economy. Having adequate resources in reserve is necessary to weather times of fiscal stress. A strong cushion is an indicator of a strong fiscal position. This report will examine how the City has structured and utilized its fiscal cushion in recent years.

The fiscal cushion of most state and local governments takes the form of an unreserved fund balance, or a rainy day fund, which is established with surplus resources from revenues that come in above expenditures for use in a future year when revenues are short, or to mitigate the impact of expense shocks. New York City however, is required to balance its operating budget according to generally accepted accounting principles (GAAP) which mandates that revenues in a given year must equal or exceed expenditures in the General Fund in that year.¹

The balanced budget requirement stems from the Financial Emergency Act (FEA) of 1975, which was enacted after New York City almost defaulted on its obligations during the financial crisis. The provisions of the FEA, most of which were codified in the New York City Charter in 2005, also require the City to have a four-year financial plan and to maintain a General Reserve of at least $100 million at the beginning of the fiscal year. The FEA precludes the City from funding operating costs with capital dollars. The GAAP-balanced budget requirement mandated by State law and the City Charter explicitly prohibits the City from using surpluses accumulated in prior years in future years.

While all governments in the country practice GAAP accounting, New York City is the only major government in the country subject to GAAP budgeting. In applying this standard as a bulwark for New York City’s budget, the State’s intention was to put an end to the City practice of funding operating expenses with capital funds and obscuring operating deficits as it was doing under cash accounting in the 1970s. The discipline instilled by the FEA is evidenced by New York City passing a balanced budget each year, by no longer borrowing from the operating budget and by maintaining access to capital markets.

As successful as it has been in achieving budget balance and eliminating the financing of large operating deficits, GAAP budgeting has its limitations. A consequence of a balance requirement is that each year’s adopted

¹ “Revenue” here is understood to include those resource inflows that are defined as “other financing sources”.” “Expenditure” is understood to include outflows defined as “other financing uses” in accordance with GAAP.
budget condition appears the same as the last. The continuous balanced condition is of limited value when comparing years. It does not reveal the differences between a boon year and a challenging year.

A more helpful bellwether of the City’s financial condition is the outyear budget gaps in the financial plan. That measure has its limitations as well. While one year in the plan may look better or worse than another, the projections are only accurate to the degree to which the City can predict a future downturn. The outyear gaps can vary greatly depending on revenue projection models and certain expenditure levels, only some of which are at the discretion of the City. Any change in revenues, which are volatile by nature, distorts the entire four or five-year plan. Even though the City often forecasts revenues conservatively, when a recession occurs, revenues can drop below projections. A single year’s recession affects all subsequent years of the financial plan since each outyear is trended off a base year.

“Rolling” Resources

Another challenge of the GAAP budgeting requirement is the unintended consequence of potentially incentivizing spending unanticipated revenues within the fiscal year they are generated because these resources cannot be used for future expenses. Fortunately, instead of immediately spending rather than forfeiting these additional revenues, the City has developed several budget relief mechanisms. The first and oldest tool the City has is the “rolling” of prior year resources.

That “roll” is the amount paid in the concluding fiscal year to reduce the need for certain payments in the upcoming year. This is done by using current year additional resources to pre-pay debt service and advance subsidies to entities whose budgets are outside of the City’s General Fund such as city libraries, the Health and Hospitals Corporation (HHC) and the Metropolitan Transportation Authority (MTA). Beginning in FY 2003, the roll also included discretionary transfers to the New York City Transition Finance Authority (TFA) to pay for future TFA debt service. Even though these prepayments and subsidies reduce the City’s need to provide funds in future fiscal years, GAAP recognizes them as expenditures in the year they are made. This has enabled the City to roll prior-year resources into future fiscal years for budget relief while adhering to GAAP budgeting.

When looking back at history, a continuous pattern emerges showing that when prior-year resources rolled into a year are not used within that year, they are subsequently rolled again. Essentially, during good times, the City has typically added to the roll, resulting in a higher roll-out at the end of the fiscal year. In bad years the City has partially depleted it. However, the recurring nature of the roll is not generally apparent when viewing individual financial plans on their own. That is because the City normally budgets for the roll to be depleted in the next fiscal year. Since the City balances its budget using conservative revenue forecasts and expenditure projections, each year, it assumes that the roll is depleted. As the year progresses, if all of those resources were not in fact needed, the roll appears again to help balance the next year’s budget.

Chart 1 shows the size of the rolls since FY 2000. The chart shows that in most years the City adds to the roll, but following 9/11 and the Great Recession the City drew down upon it. When the roll was the only mechanism to use prior year resources for future years, its size provided an indication of the City’s overall fiscal health. A roll that was growing meant the City had an operating surplus and a roll that was diminishing indicated an operating deficit. The roll’s ability to provide a cushion was gauged not just by whether it was growing but also by its size.

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2 Prepayments of debt service includes prepayments for General Obligations (GO) debt service into a State controlled debt service fund and prepayments of interest support payments to Hudson Yards Infrastructure Corporation (HYIC) which the City established to finance the MTA’s #7 Line Extension.
Until FY 2006, the most significant elements of New York City’s budgetary cushion consisted of: (1) rolls from prior fiscal years and (2) the General Reserve. The General Reserve is a contingency resource for the current year and is budgeted as an expense. Unlike the roll, it has to be used within the current year. Increasing the General Reserve boosts the intra-year cushion.

In the last decade, the City has found other budget tools to accumulate resources for the outyears. At the end of FY 2006, with additional resources on hand, the City established the Retiree Health Benefits Trust (RHBT) to fund its “Other Post-Employment Benefits” (OPEB) liability. In FY 2006, the City deposited $1 billion into the RHBT followed by another $1.5 billion in FY 2007. The City funds the Trust to pay the health and welfare benefits of future and current City retirees and their dependents. Since the establishment of the Trust, payments for pay-as-you-go health and welfare benefits for current retirees have been paid out of the RHBT. The City then replenishes the Trust by the same amount.

The primary purpose of the RHBT is to fund the liability of already earned retiree healthcare benefits. The City needs to regularly make deposits so that the funding level can stem the growth and eventually begin to reduce this significant $90 billion liability. Its use as a cushion, as described below, is temporary and incidental to its primary purpose. During good times, the City should more than replenish any drawdown, since the purpose of the fund is to ultimately accumulate funds towards its OPEB liability.
In the aftermath of the Great Recession, the City used assets accumulated in the RHBT to provide short-term budget relief. The RHBT continued to fund the full benefit payments for retirees and their dependents but the City replenished the Trust with less than what it paid out. The City thereby used the RHBT’s previously accumulated assets to pay a portion of the City’s retiree health and welfare benefits costs. In FYs 2010 through 2013, the City used $2.1 billion in RHBT assets for budget relief. Beginning in FY 2014, the City has taken steps to build up the RHBT. It cancelled a scheduled withdrawal of $1 billion and instead deposited $864 million in FY 2014 and $955 million in FY 2015 above what it deposited to cover current retirees’ health benefits.

The City employed another financial tool in FY 2006 when it began to use bond defeasances to roll resources from current fiscal years to the Financial Plan outyears. Defeasance has the effect of fully or partially retiring bond obligations from the budget – reducing or eliminating associated debt service. Just like the roll, defeasances allow the City to use current year resources to provide outyear budget relief.

Other means by which the City used current year resources for future year budget relief include delaying the receipt of FYs 2006 and 2007 tobacco settlement revenues to FY 2008 and a pre-payment of FYs 2007 and 2008 HHC subsidies not included in the FY 2006 roll. This year, New York City established the Capital Stabilization Reserve (CSR), first reflected in the FY 2016 Executive Budget, which provides the City with another way to use current resources for future budget relief. The primary purpose of the CSR is to fund initial non-capital eligible design and planning for capital projects but it may also be used to defease bonds to produce outyear savings. Any balance in the CSR at the end of the fiscal year is rolled into the next fiscal year through prepayments of the following year’s expenditures.

**PARR: A New Measure of the Fiscal Cushion**

The Comptroller’s Office has developed a new measure to quantify the City’s fiscal cushion and evaluate its ability to react to economic downturns. The Comptroller’s Office describes New York City’s fiscal cushion as Prior-year Accumulated Resources and Reserves (PARR). The PARR is defined as total prior year resources and reserves available, at the sole discretion of the City, for current or future budget balance. In FY 2016, the PARR consists of:

- Resources used to prepay debt service and subsidies – i.e., the roll.
- The General Reserve at the beginning of the year which is a contingency reserve and can then serve to increase the roll at the end of the fiscal year.
- The Retiree Health Benefits Trust, because fund assets excluding the deposits for the pay-as-you go portion of retiree health insurance costs can potentially be drawn down in the future to reduce General Fund retiree health expenditures.
- Bond defeasance since it uses current year resources to reduce outyear debt service.
- The Capital Stabilization Reserve because any funds not used in the current fiscal year can be used to prepay debt service or defease bonds.

Once the roll ceased to be the only element of the PARR, its size was no longer indicative of the City’s fiscal condition. As shown in Chart 1, the City added $701 million to the roll in FY 2010 which suggested that the City had a surplus in that year and had added the surplus to the roll. In actuality, in FY 2010 the City benefitted from $2.77 billion in savings from prior bond defeasances and the use of funds from the RHBT. That year, the increase in the roll was funded by $701 million of these savings, resulting in a net drawdown of $2.08 billion of the PARR.
Mitigating Measures

The PARR is a critical tool in helping the City get through tough times. In times of fiscal stress, aside from using the PARR, the City only has three other options for budget relief: (1) reducing expenditures often through hiring freezes, attrition and layoffs and service cuts; (2) increasing revenues by increasing taxes, increasing fees and fines and/or stepping up collection enforcement; and (3) extraordinary federal and state measures, such as aid packages and special authorization to issue recovery bonds. The City typically uses a combination of these measures to achieve budget relief in severe downturns.

Examples of how the City used budget relief measures to adapt to newfound expenses and revenue declines after 9/11 include:

- Reducing expenses by including a severance and early retirement initiative worth $100 million to reduce expenditures in the Preliminary FY 2003 Budget.
- Boosting revenues by increasing property taxes by 18.5% which raised $8.4 billion from FY 2003 through FY 2007 and temporarily increasing the Personal Income Tax from FY 2004 to FY 2006 which generated $1.7 billion.³
- New York State authorizing the City to issue $2 billion of Disaster Recovery Bonds for operating purposes. The City issued $1.9 billion.
- Drawing down the PARR by $243 million in the first year and a cumulative $2.3 billion by the next year.

Similarly, following the Great Recession the City’s budget relief measures included:

- Cutting expenses by including an attrition and layoff plan worth $118 million in its Preliminary FY 2010 budget.
- Increasing revenues by raising the sales tax by 0.5 percent which generated $15.9 million in FY 2009, $438 million in FY 2010, $580 million in FY 2011 and $610 million in FY 2012.
- Drawing down on the cushion by $1.9 billion in the first year of the crisis, culminating in a cumulative $6.2 billion at the low point in 2014.

Because the City uses a combination of the measures above, a stronger PARR allows the City to depend less on budget cuts, tax increases or extraordinary aid. The size of the PARR is therefore a meaningful indicator of how prepared the City is to face a recession and is a good gauge of the City’s financial condition, since it determines the degree to which other budgetary actions must be taken. In addition, when circumstances are not dire and moderate budget pressures arise, having a cushion to draw upon can help avoid other, less desirable actions.

Historical Use

Chart 2 shows the change in the City’s budget PARR since FY 2001. Following the terrorist attacks on September 11, 2001 and the downturn in the local economy that followed, the City drew down $2.5 billion of its $3.4 billion PARR to balance the budget in FYs 2001 and 2002 leaving a cushion of just $881 million in FY 2003.

³ In FY 2008 the City reduced the property tax rate by 7 percent to 11.423 percent. In FY 2009, the City rescinded the reduction and raise the property tax back to 12.283 percent.
As tax revenues recovered in FY 2003, the City almost doubled its PARR in FY 2004. As tax revenues continued to strengthen, the City continued to add to the PARR until it reached a peak of $10.9 billion at the start of FY 2009.

Chart 2. Cushion Available at the Beginning of the Fiscal Year
($ in billions)

In FY 2009, the City began to feel the effect of the Great Recession, which was larger and more sustained than the downturn in the aftermath of 9/11, making the City’s use of the PARR larger and more prolonged. Even as tax revenues started to recover in FY 2010, they did not rebound to their pre-recession peak until FY 2011. This means that operating revenues generated in the years following the recession were still below the City’s operating expenditures. In addition, the City sustained cuts to both federal and state aid which it backfilled with City tax levy. The City used a cumulative $6.2 billion of the PARR from its peak of $10.9 billion to balance the budget. That drawdown was in addition to budget savings plans and measures to increase revenue that were implemented as a result of those tough times. The City did not begin to add to the PARR again until FY 2014. Chart 3 shows the relationship between tax revenues in the recovery and the replenishment of the PARR.
Chart 3. PARR Level Compared with Tax Revenue Level
($ in billions)

Current PARR

As of the start of FY 2016, the City’s PARR is comprised of a $3.55 billion roll, $1 billion in the General Reserve, the new $500 million Capital Stabilization Reserve, $103 million from bond defeasance and $3.3 billion in the RHBT, bringing the current PARR to $8.5 billion or 10.5% of the adjusted operating budget. Chart 4 shows the PARR as a percent of the adjusted expenditures going back to FY 2001. Both tax revenues and the number of jobs in New York City exceed their pre-recession levels, but the City’s PARR is still below what is was going into the recession.

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\(^4\) Adjusted to reflect removal of prior-year resource uses and reserves.
Achieving an Adequate PARR

Evaluating the amount of cushion the City needed to get through past downturns provides context with which to assess the appropriate PARR range. After 9/11, even as the City took a number of measures to avoid relying completely on the PARR, it still used $2.5 billion to make up for revenue losses and balance the budget. As a percent of the adjusted operating budget, the PARR dropped almost six percentage points from 8.2% to just 2.0%. To address the impact of the Great Recession, including the loss of state and federal funds, the City utilized $6.2 billion of the PARR. As a percent of the adjusted operating budget, the PARR dropped by eleven percentage points from 17.4% to 6.4%.

When assessing local government’s credit worthiness, rating agencies generally look at the proportion of an entity’s reserves in relation to the size of its budget. Since the City cannot utilize a rainy day fund or available fund balance, the rating agencies evaluate the size of the roll and the reserves, which makeup the GAAP-basis available fund balance, or, the cushion, essentially the PARR. The size of the cushion informs how flexible the City’s budget is to weather unexpected conditions and the City’s financial health is evaluated in relation to that flexibility. The budget must be able adjust to unforeseen circumstances in order for the City to serve its citizens.

When explaining how it judges the strength of local government finances, Moody’s assesses whether reserves are in line with budget growth. They measure the fund balance as a percentage of revenues for the current year and over five-year periods. The Moody’s scorecard suggests a 15% to 30% fund balance for Aa credits like...
New York City. Standard and Poor’s scores budget flexibility in ranges and considers an available fund balance range of 8% to 15% as strong and a balance above 15% as very strong.

The Comptroller’s Office’s methodology for measuring a strong cushion is similar. The Office measures the cushion compared to total expenditures to yield the PARR ratio. Based on the City’s experience in addressing recent recessions as well as the rating agencies’ standards, the City should maintain a healthy PARR between 12% and 18% of the adjusted operating budget, with 15% being the midpoint and the norm. The Comptroller’s Office’s target range is designed to reflect the countercyclical nature of the PARR. It should be built up in good times and drawn down – to a reasonable extent – in bad times. After a drawdown amidst a recession, the budget should be crafted in a way that moves the PARR back up to 8% of operating expenditures and then up to 12%. After several years of solid revenues and recovery, the City should work to build the PARR above 15% and ultimately get it to 18%.

New York City’s cushion at the start of FY 2016 is currently $8.5 billion or 10.5% of adjusted expenditures which is $1.2 billion short of a 12% PARR. To achieve 15%, it would need to add $3.6 billion and to reach 18%, it would need over $6 billion. The current FY 2016 cushion, which is $3.15 billion above what it was in the previous fiscal year, reflects how since FY 2014, the City has begun to build its cushion back up. It is important that the City continue on this positive path so that the PARR reaches or exceeds what it was before the Great Recession.